Prague, 1 July 2020

Positive Mood Survives on Equity Markets

The equity markets slightly increased in the course of the past month: the S&P 500 Index leaped over the 3100 points mark and it improved by 1.8 percent in June. The American Equity Index has been losing only about 4 percent since the beginning of the year. Over the past month, the technology sector and the consumer durables sector have strengthened the most of all. On the other hand, the utilities sector and the energy sector recorded the worst performances in the past month.

The FED published its cautious forecast on Wednesday 10 June which – combined with increased numbers of Covid-19 cases in some states of the U.S.A. (e.g., Arizona, Florida, Texas, and California) – resulted in the largest drop in stock markets since March 2020 on the very next day. The FED estimates in its forecast a 6.5 percent decline in the GDP in the U.S.A. this year, and its subsequent major increase by 5 percent in the year to come. Unemployment is expected to drop from the current 13.3 percent to 9 percent at the end of 2020, and to 6.5 percent in 2021. In order to support the economy, the FED plans to keep the key interest rate at technical zero during 2022 and it does not even consider any raising of rates. According to the FED, the economic outlook is still uncertain and it will depend above all on how quickly the coronavirus pandemic subsides and whether sufficient vaccines and medicaments against the disease can be secured in time.

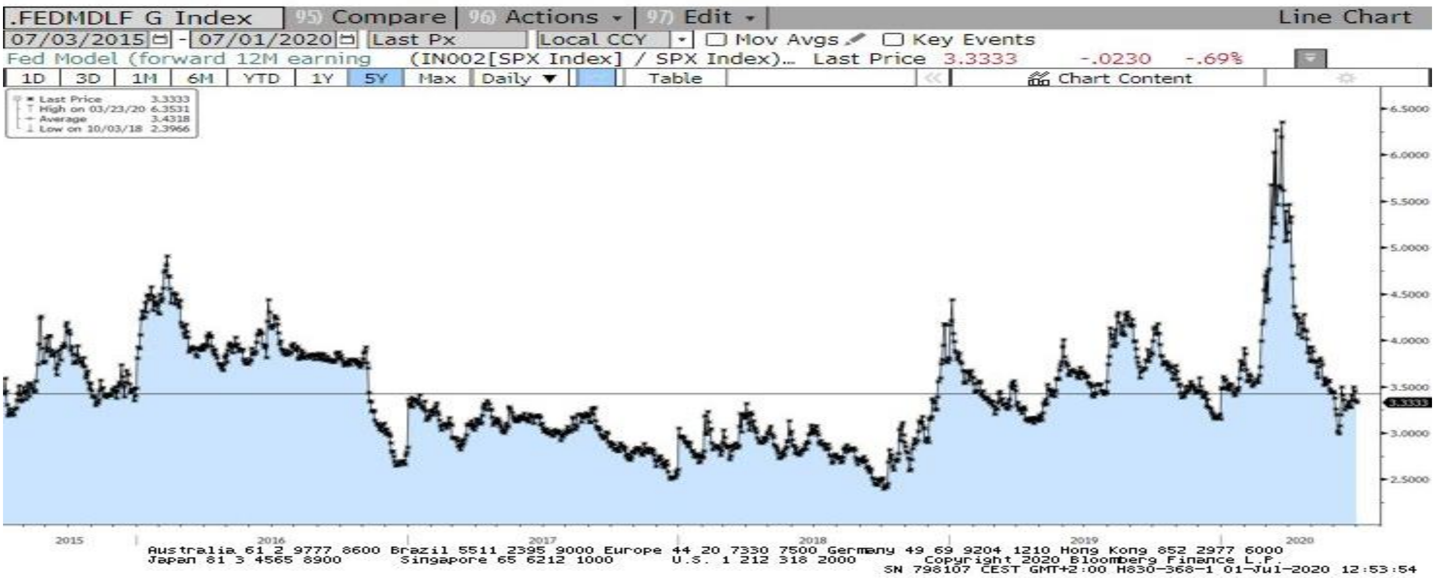
Still, investors have welcomed some better than expected economic indicators published in the course of June. For example, May retail sales jumped up by 17.7 percent in the U.S.A., month-to-month, although the markets envisaged a mere 8.4-percent-growth. Also the Purchasing Managers' Index in production in China was better than analysts' forecasts, having reached the value of 50.9, which indicates 'economic expansion'.

Michal Ondruška
Manager, Asset Management

Financial markets have continued to enjoy a significant backing from both the monetary and fiscal policies. The FED, apart from lowering interest rates, continues to purchase sovereign bonds to the tune of USD 80 billion per month, and it has also begun to buy corporate bonds and mortgage bonds. The U.S. Government is about to propose another fiscal incentive in the amount of USD 1 trillion, which aims at investments into infrastructures, including 5G networks. Similar programmes supporting the economy have also been implemented in Europe.

July marks in the U.S.A., and subsequently in Europe, the beginning of the season of publication of corporate results for the second quarter of the year. Analysts estimate that the aggregate profit of the S&P 500 Index will fall by more than 43 percent and sales by more than 11 percent in the second quarter of this year (*Source*: FactSet). It will be interesting to see the outlook of corporate managers regarding the end of this year, since company results are likely to improve. It is expected that the S&P 500 Index firms may start to generate profit and sales growths next year again, by 28.7 percent for profits and 8.5 percent for sales (*Source*: FactSet).

The S&P 500 Index has been trading with the envisaged P/E of 21.9 over the next 12 months, which is more than the average expected P/E of 16.9 over the past five years (*Source*: FactSet). Nevertheless, the yield of a 10-year American government bond has been low, about 0.70 percent, and that encourages higher stock valuations, as companies have cheap financing and investors do not find bonds that attractive. The anticipated risk premium according to the FED model is around its five-year average of 3.4 (*Source*: Bloomberg), which indicates that equities have been neither expensive nor inexpensive.



Source: Bloomberg

According to RBI analysts, the S&P 500 index will reach the value of 3300 points at the end of the year, which would represent its strengthening by approximately 6.4 percent as against the current figure (*Source:* RBI). As regards future risks, we would like to mention the U.S. presidential election to be held in the autumn, since a winning Democratic candidate may seek higher corporate taxing; yet another coronavirus wave, if a sufficient amount of vaccine and effective medicine cannot not be produced in time; and tense relations with China.

During the entire month of June, risk assets were overweighed in our managed portfolios and funds at the expense of conservative instruments. Nevertheless – in particular as regards funds – the ratio of such overweighing was actively managed and its level was either increased or lowered in response to the current developments prevailing on the relevant markets and in keeping with the investment strategies of the individual funds. As regards bond components, the general strategy was to sell long-term sovereign bonds and, on the contrary, to purchase sovereign and corporate bonds with shorter maturity. We have sold, for example, the 10-year Czech government bond which – following a local drop in price – has been rising again and nearing its historical maxims. On the other hand, we have purchased a variable coupon bond which will profit from a potential economic revival. Also purchased across the funds was, for example, a two-year LeasePlan bond in an IPO. As regards bonds in other currencies, we repeatedly invested in short-term debt securities denominated in the U.S. dollar. On the equity side, trading largely related to sector ETF funds; we can mention, for example, purchases in the area of technologies, health services, basic consumption or real estates. We also invested in shares in such premium firms as Amazon, Apple, Facebook, Google, Netflix, Microsoft, Nvidia; or – on the Czech side – for example, Komerční Banka.

Investment Strategy Summary:

• As regards our tactical asset allocation, we have slightly **overweighed equities over bonds**.
• As regards tactical regional allocation, we have overweighed the **regions of the U.S.A. and Europe**, while slightly under-weighing the Pacific region and the emerging markets.
• As regards tactical sector allocation, we have overweighed the areas of **technologies, health services, finance, and the dividend-bearing equities segment.**
• Following major price increases (drops in yield), particularly in the segment of fixed-interest sovereign bonds, we have considered the bond markets as relatively expensive. As compared to the benchmark, we have therefore **maintained shorter average terms to maturity (so-called 'duration').**
• As against the benchmark, we have tactically **overweighed the share of premium corporate bonds.**

Thank you for your attention, and we wish you a nice time during the summer months.

Sincerely,

Michal Ondruška

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